



**Congressional
Research
Service**

MEMORANDUM

January 21, 2009

To: Honorable Jim McDermott
Attention: Jayme White

From: [REDACTED]

Subject: Analysis of Whether a Newspaper Could Qualify as a § 501(c)(3) or § 501(c)(4) Organization

This memorandum responds, on a rush basis, to your request for an analysis of whether a non-profit entity that prepares and publishes a newspaper could qualify for tax-exempt status as a § 501(c)(3) or § 501(c)(4) organization.¹ The newspaper would contain news stories of general interest to the public. The memorandum also provides examples of newspapers utilizing tax-exempt entities in their structures.

Section 501(c)(3) of the Internal Revenue Code (IRC) describes charitable organizations, which include organizations with educational purposes.² One type of organization described in IRC § 501(c)(4) is the social welfare organization,³ which must be "primarily engaged in promoting in some way the common good and general welfare of the people of the community."⁴ The tax-exempt purposes of charitable and social welfare organizations overlap so that an organization qualifying for tax-exempt status under § 501(c)(4) may also meet the criteria to qualify under § 501(c)(3).⁵ The organizations differ in two

¹ There are constitutional implications to this question since the denial of tax-exempt status to a newspaper organization could raise freedom of speech and press issues under the First Amendment. The government may choose to not subsidize a taxpayer's speech through the provision of a tax incentive. See *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 545, 548 (1983); *Speiser v. Randall*, 357 U.S. 513, 519 (1958). At the same time, a court will look closely at the IRS's denial of tax-exempt status when it is based on the content of an organization's speech in order to ensure that the denial was not done for constitutionally impermissible reasons. See, e.g., *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030 (D.C. Cir. 1980) (holding the definition of "educational" in a Treasury regulation was unconstitutionally vague because it provided the IRS with too much discretion to deny tax-exempt status to a controversial advocacy organization; the court later indicated in *National Alliance v. United States*, 710 F.2d 868, 875 (D.C. Cir. 1983), that the IRS's methodology test for determining whether such an organization met the regulation's criteria "reduces the vagueness" concerns).

² See IRC § 501(c)(3) (describing entities "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition ... or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation ... and which does not participate in, or intervene in ... any political campaign on behalf of (or in opposition to) any candidate for public office").

³ See IRC § 501(c)(4) (describing "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare" with "no part of the net earnings of such entity inur[ing] to the benefit of any private shareholder or individual").

⁴ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

⁵ See *id.*

significant ways. First, § 501(c)(3) organizations are eligible to receive tax-deductible charitable contributions, while § 501(c)(4) organizations are not.⁶ Second, § 501(c)(3) organizations are substantially limited in their ability to lobby and are prohibited from intervening in political campaigns, while § 501(c)(4) organizations may conduct any amount of permissible lobbying and engage in campaign activity so long as it is not their primary activity.⁷ Thus, if an organization's agenda depends on influencing public opinion or the legislative process, it may be appropriate to form as a § 501(c)(4) organization. For other organizations, it will usually make more sense to be a § 501(c)(3) organization in order to have the advantage of tax-deductible contributions.

§ 501(c)(3) status

One criteria for § 501(c)(3) status is that an organization must be "organized and operated exclusively" for a tax-exempt purpose — here, an educational purpose.⁸ The term "educational" is not defined in the tax code. A Treasury regulation defines the term to include "instruction of the public on subjects useful to the individual and beneficial to the community."⁹ The term "educational" may include the preparation and distribution of informational materials.¹⁰ Thus, it appears an organization that prepared and distributed news articles could argue that it has a tax-exempt "educational" purpose because it benefits the community by educating the public on important current events and issues.

However, an organization whose primary activity is publishing a newspaper may have difficulty qualifying for § 501(c)(3) status. This is because the IRS and courts have previously denied tax-exempt status to organizations with significant publishing activities when those activities were indistinguishable from ordinary commercial practices.¹¹ Factors the courts and IRS have looked at in determining that an organization's publishing activities were not too commercial include:

- the publication was not intended to generate a profit, which was typically exhibited by it being sold at a reduced price (e.g., below cost) and not the same price charged by commercial publishers;

⁶ See IRC § 170(c).

⁷ See IRC § 501(c)(3), (c)(4).

⁸ IRC § 501(c)(3). Basically, the organizational and operational tests are violated if the articles of organization include a substantial non-exempt purpose or permit more than an insubstantial amount of activities that do not further a tax-exempt purpose, or if the organization actually has such a purpose or conducts too much of such activities. See Treas. Reg. § 1.501(c)(3)-1(b), 1(c)(1); *Better Business Bureau v. United States*, 326 U.S. 279 (1945).

⁹ Treas. Reg. § 1.501(c)(3)-1(d)(3). Additionally, an organization that "advocates a particular position or viewpoint" may be educational "so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion." This test was declared unconstitutionally vague by the U.S. Court of Appeals for the D.C. Circuit in *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030 (D.C. Cir. 1980), although the court later indicated in *National Alliance v. United States*, 710 F.2d 868, 875 (D.C. Cir. 1983), that the IRS's methodology test for determining whether the regulation's criteria were met "reduces the vagueness" concerns.

¹⁰ See, e.g., Rev. Rul. 66-147, 1966-1 C.B. 137; Rev. Rul. 68-307, 1968-1 C.B. 258; see also, Tommy F. Thompson, *The Unadministrability of the Federal Charitable Tax Exemption: Causes, Effects and Remedies*, 5 VA. TAX REV. 1, 9 (1985) (stating "it is difficult to confine the term ['educational'] to anything less than the dissemination of information").

¹¹ See Rev. Rul. 67-4, 1967-1 C.B. 121 (ruling that an organization that prepares and publishes written materials may qualify as a § 501(c)(3) educational organization if: (1) the publication's content is educational, (2) the preparation of the publication follows methods generally accepted as educational in character, (3) distribution of the publication is necessary or valuable in achieving the organization's tax-exempt purpose, and (4) the manner in which distribution is accomplished is distinguishable from ordinary commercial publishing practices); see also discussion, *infra* note 12 and accompanying text.

- the publication did not generate a profit and the organization relied on grants and contributions (i.e., non-subscription sources of income) to cover the publication's operating deficits;
- the organization did not have substantial accumulation of earnings;
- the organization did not significantly rely on paid advertising to support the publication and such advertising was not a substantial part of the publication;
- the publication was provided for free or reduced cost to those unable to pay for it, the elderly, prisoners, libraries, etc.;
- the organization made choices in its operations that reflected its tax-exempt purpose and would not be made by commercial entities (e.g., printing articles without regard to their impact on advertisers);
- the organization did not compete with commercial entities;
- the publication did not include materials with a commercial appeal (e.g., sports and entertainment articles); and
- the organization's staff had specialized skills and expertise.¹²

Part of the difficulty in analyzing whether an organization's activities are distinguishable from ordinary commercial practices is that the commerciality doctrine is not consistently applied by the courts.¹³

The commerciality factor may require careful consideration when determining how a newspaper organization seeking § 501(c)(3) status is structured and operated. For example, it appears that an organization publishing a general interest newspaper that has paid staff with skills typically found at

¹² See, e.g., *Peoples Translation Service/Newsfront International v. Comm'r*, 72 T.C. 42 (1979) (finding that an organization that published translations of international articles on social movements did not operate in a commercial manner when its subscription rates were insufficient to cover costs; it donated publications to those unable to pay; it spent negligible amount on advertising; it did not sell advertising space; it did not pay or receive royalties or obtain copyrights; its officers and directors had specialized language skills; and translations were done by volunteers); Rev. Rul. 67-4, 1967-1 C.B. 121 (granting § 501(c)(3) status to a medical advocacy organization that published a journal about specific disorders when its staff were medical specialists and teachers, most of whom were volunteers; the journal was sold below cost; and operating deficits were defrayed by contributions and government grants); Rev. Rul. 66-147, 1966-1 C.B. 137 (granting § 501(c)(3) status to an organization that prepared abstracts of international scientific and medical literature when the organization's staff had specialized medical, scientific, and foreign language skills, and the materials were distributed free of charge); Priv. Ltr. Rul. 8351008 (Sept. 24, 1983) (granting § 501(c)(3) status to a human rights organization that, among other activities, published a journal when the journal was given free of charge to those unable to pay for it, the elderly and others; the journal articles were chosen by an editorial board consisting of authors and journalists in consultation with an advisory board of the organization's research fellows; articles were published without regard to whether they would negatively affect advertising; the journal did not generate a profit and the organization was reliant on grants, contributions, and income from other activities; and some journal articles were rewritten and distributed for free to radio stations for broadcast); Rev. Rul. 77-4, 1977-1 C.B. 141 (ruling that an organization publishing a weekly newspaper that contained local, national, and international news items of interest to a particular ethnic group did not qualify for § 501(c)(3) status because its only activities — publishing a newspaper, soliciting advertising, and selling subscriptions — were done in a manner indistinguishable from commercial practices; facts included that the newspaper had substantial commercial advertising and was put together by paid staff who had no special skills other than those generally found in newspaper staff); see also *The Incorporated Trustees of the Gospel Worker Society v. United States*, 510 F. Supp. 374 (D.D.C. 1981) (holding that a publishing organization did not qualify for § 501(c)(3) status because of its significant accumulation of profits; the excessive salaries of its high-level employees; and its competition with commercial publishers as evidenced by its practices of paying royalties, offering standard commercial discounts to dealers, and aiming its publications at commercial markets).

¹³ See, e.g., John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WM AND MARY L. REV. 487 (2002); Thomas Kelley, *Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Nonprofit Law*, 73 FORDHAM L. REV. 2437 (2005).

newspapers, relies solely on subscriptions and advertising to cover costs, and contains articles with commercial appeal (e.g., sports and entertainment articles) could have difficulty in qualifying for § 501(c)(3) status. On the other hand, a newspaper organization structured and operated in a different manner — e.g., one that relies on grants and contributions for funding, has an advisory board of experts on relevant issues who select articles for publication regardless of commercial impact, and sells its publication to subscribers at a reduced cost — could potentially avoid the commerciality issue. The outcome will depend on the facts and circumstances of each case and the court's application of the commerciality doctrine; thus, it is not possible to provide a definitive rule as to the exact characteristics the organization would be required to have.

§ 501(c)(4) status

A § 501(c)(4) social welfare organization must be “primarily engaged in promoting in some way the common good and general welfare of the people of the community.”¹⁴ A Treasury regulation clarifies that an organization “operated primarily for the purpose of bringing about civic betterments and social improvements” may qualify for § 501(c)(4) status.¹⁵ An argument could be made that an entity that prepared, published, and distributed information to the public has a social welfare purpose.

However, the Treasury regulation goes on to say that an organization is not “operated primarily for the promotion of social welfare if its primary activity ... is carrying on a business with the general public in a manner similar to organizations which are operated for profit.”¹⁶ Thus, a newspaper organization seeking § 501(c)(4) status would appear to face issues similar to those discussed above. If publishing the newspaper was a substantial activity of the organization, then it appears the organization would have to be able to distinguish its publishing activities from commercial publishing.

Examples

It has been suggested that one way for a newspaper to remain viable during the current difficult period for the newspaper industry is to utilize a structure that includes a tax-exempt entity.¹⁷ As the above analysis indicates, it may be difficult for a newspaper organization that engages in traditional (i.e., print) publishing practices to qualify for § 501(c)(3) or § 501(c)(4) status. There several examples of online newspapers with § 501(c)(3) status, including the New Haven Independent (New Haven, Conn.),¹⁸ MinnPost (Minneapolis/St. Paul, Minn.),¹⁹ and Chi-Town Daily News (Chicago, Ill.).²⁰ Among the features distinguishing these entities from traditional newspapers is that they provide information for free on their websites and are funded through grants from foundations and contributions by individual donors. Another example is ProPublica, which describes itself as an “independent, non-profit newsroom.”²¹ ProPublica offers its news stories for free to traditional news organizations for publication or broadcast.

¹⁴ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

¹⁵ *Id.*

¹⁶ Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii); see also *People's Educational Camp Soc. v. Comm'r*, 39 T.C. 756 (1963).

¹⁷ See, e.g., Joe Mathewson, *Non-Profit Model for Newspapers May Be the Answer*, EDITOR & PUBLISHER, Dec. 22, 2008; Joe Nocera, *A Lifeline of Sorts to Newspapers*, NY TIMES, June 23, 2007; Ryan Blitstein, *The Bottom Line for Nonprofit News*, March 04, 2008, available at [<http://www.miller-mccune.com/article/189>].

¹⁸ See [http://www.newhavenindependent.org/about_us.php].

¹⁹ See [<http://www.minnpost.com/about/>].

²⁰ See [<http://www.chitowndailynews.org/>].

²¹ ProPublica, About Us, available at [<http://www.propublica.org/about/>].

The stories, along with reporting produced by others, are later available for free on the organization's website. ProPublica is funded by foundation grants and seeks donations from its readers. In our time-limited search, we were unable to find any newspaper organizations with § 501(c)(4) status.

Rather than have the newspaper operate as a tax-exempt entity, another possible structure is for the newspaper to be owned by a tax-exempt organization. An example of this structure is the relationship between the Poynter Institute for Media Studies and Times Publishing Co.²² Times Publishing is a taxable, for-profit company that publishes the St. Petersburg Times, Congressional Quarterly, Florida Trend magazine, and Governing magazine. It is owned by a holding company whose sole stockholder is the Poynter Institute, which is a § 501(c)(3) journalism school.

Finally, we found other examples of newspaper or reporting organizations that use a tax-exempt entity in their structure. For example, the Associated Press operates as a cooperative owned by its newspaper members. Another example is that some newspapers have been structured as employee stock ownership plans (ESOPs). These include the Milwaukee (Wisc.) Journal Sentinel, Monroe (Mich.) Evening News, Dubuque (Iowa) Telegraph Herald, and Peoria (Ill.) Journal Star.²³ The one that has received the most attention was the ESOP structure used by Sam Zell in purchasing the Tribune Company (publisher of the Chicago Tribune, Los Angeles Times, and Baltimore Sun, among others) in 2007.²⁴

²² See [http://www.poynter.org/content/content_view.asp?id=8090].

²³ The Peoria Journal Star ESOP later ended, reportedly because so many employees intended to cash out of the plan. See John Morton, *A Plan Doomed by High Profits*, AMERICAN JOURNALISM REVIEW, Dec. 1995, available at [<http://www.ajr.org/Article.asp?id=82>].

²⁴ See, e.g., Susan Chandler, Julie Johnsson and Michael Oneal, *An ESOP Surely; Zell's Probably*, CHI. TRIB., April 1, 2007; Allen Sloan, *Tribune Deal Makes Zell Ace of Tax Dodgers*, WASH. POST., May 1, 2007; Emily Thornton, *Tribune Bankruptcy Snares Employees*, BUSINESSWEEK, Dec. 8, 2008.